

South Carolina Board of Economic Advisors

Statement of Estimated State Revenue Impact

Date: April 8, 2008 (As amended April 3, 2008 by the Senate Finance Committee)

Bill Number: H.B. 3567

Authors: Rice; Gullick; Cotty; Agnew

Committee Requesting Impact: Senate

Bill Summary

A bill to amend Section 12-21-620, of the Code of Laws of South Carolina, 1976, relating to taxation on cigarettes, so as to increase the amount of tax on each cigarette from three and one-half mills to two cents; to add Section 44-6-157 so as to provide that the revenue generated from the taxation on cigarettes must be used to expand Medicaid coverage to children eighteen years of age and younger whose family income does not exceed two hundred percent of the federal poverty level; and to create the Health Care Trust Fund to provide Medicaid benefits to individuals whose family income does not exceed one hundred percent of the federal poverty level and who are uninsured and to provide that revenue in excess of the children's Medicaid coverage from the cigarette tax must be credited to the Health Care Trust Fund; and to amend Section 12-36-910, as amended, relating to sales taxes generally, so as to provide that as of July 1, 2009, the three percent sales tax is eliminated on unprepared food which lawfully may be purchased with United States Department of Agriculture food coupons, to provide for certain general fund transfers to the Education Improvement Act Fund for each fiscal year to offset EIA revenues lost as a result of the loss of sales tax on the sale of unprepared food, and to reduce the sales tax on unprepared food to two percent as of July 1, 2007, and one percent as of July 1, 2008.

REVENUE IMPACT ^{1/}

This bill, as amended, is expected to generate \$158,300,000 in FY2008-09 after a loss of \$1,500,000 for stockpiling. This amended bill is expected to increase funds in the Medicaid Trust Fund by an estimated \$153,300,000 in FY2008-09 and increase funds in the Smoking Prevention and Cessation Trust Fund by \$5,000,000 in FY2008-09. Because the higher tax will reduce cigarette demand, cigarette taxes currently allocated to the General Fund will be reduced by an estimated \$3,727,065 in FY2008-09.

Explanation of Amendment (April 3, 2008) – By the Senate Finance Committee

This amendment would strike all after the enacting words and insert the following:

Section 1. This section would add Section 12-21-625 to impose 50-cent surtax on each pack of 20 cigarettes beginning July 1, 2008 and is expected to generate an estimated \$158,300,000 in FY2008-09 after a loss of \$1,500,000 for stockpiling. The surtax would be credited to the Medicaid Trust Fund and used for those purposes as described in Section 4. Because the higher tax will reduce cigarette demand, cigarette taxes currently allocated to the General Fund will be reduced by an estimated \$3,727,065 in FY2008-09. Beginning on July 1, 2009, and every year thereafter, the Department of Revenue will adjust the surtax on cigarettes by the average percentage increase in the last three calendar years, if any, in the medical services component of the Consumer Price Index for All Urban Consumers, as certified by the Board of Economic Advisors.

Section 2. This section would create in the State Treasury a separate and distinct fund styled the Medicaid Trust Fund to receive revenues from the surtax on cigarettes. Earnings and interest on the fund must be credited to the fund and the Treasurer will transfer funds to the Department of Health

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and Human Services on a quarterly basis. There is also created in the State Treasury a separate and distinct fund styled the Smoking Prevention and Cessation Trust Fund. Earnings and interest on the fund must be credited to the fund. Each fiscal year, the first \$5,000,000 credited to the Medicaid Trust Fund must be transferred to the Department of Health and Environmental Control to administer a statewide smoking prevention and cessation program.

Section 3. This section amends Section 12-21-620 by adding subsection (B) that beginning on July 1, 2009, and every year thereafter, the Department of Revenue will adjust the seven cents per pack tax on cigarettes remaining in the General Fund by the average percentage increase in the last three calendar years, if any, in the medical services component of the Consumer Price Index for All Urban Consumers, as certified by the Board of Economic Advisors.

Section 4. Of the funds transferred to the Department of Health and Environmental Control from Section 2 of the amendment, the department will utilize the funds in the following order – setting the Low Income Family Program at 100% of the federal poverty level; setting the Aged, Blind, and Disabled Program at 135% of the federal poverty level; and setting the State Children's Health Insurance Program at 250% of the federal poverty level.

Section 5. This section limits purchases by wholesalers, distributors, and retailers to one month of no more than 110% of the average monthly amount of cigarettes purchased in the same three months of the previous calendar year in April, May, and June of 2008. Violators are subject to an audit by the Department of Revenue and subject to a civil fine equal to five times the amount of tax owed on the purchased cigarettes in excess of the 110% stockpiling limitation.

Section 6. This section creates the Study Committee on Healthcare Access and Affordability.

Section 7. Except where otherwise stated, this act takes effect upon approval by the Governor.

Explanation of Updated Fiscal Impact (February 20, 2008)

Section 1. This section would add Section 12-21-625 to impose 45-cent surtax on each pack of 20 cigarettes beginning July 1, 2008 and is expected to generate an estimated \$146,750,000 in FY2008-09. The surtax would be credited to the General Fund and used for those purposes as the General Assembly determines by law.

Section 2. Similar language contained in this section was adopted in Act 115 of 2007.

Section 3. Similar language contained in this section was adopted in Act 115 of 2007.

Section 4. The language contained in this section was adopted in Act 115 of 2007.

Section 5. This section would create in the State Treasury the Health Care Trust Fund that is separate and distinct from the General Fund that would receive state appropriations of \$90,000,000 each fiscal year. This section would also create in the State Treasury the Smoking Cessation Trust Fund that is separate and distinct from the General Fund that would receive state appropriations of \$5,000,000 each fiscal year. Earnings on these funds must be credited to each respective fund and any remaining balance in the fund at the end of each fiscal year may be carried forward to succeeding fiscal years.

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Section 6. This section would add language from S.B.704 that would amend Section 12-21-735 to require a manufacturer or wholesaler of cigarettes to affix a tax stamp to the bottom of each individual package of cigarettes that is intended for sale or distribution within the State.

Section 7. This section would amend Section 12-21-620(2),(3) to change the basis of taxation on moist snuff tobacco from five percent of the manufacturer's price at which a manufacturer sells to a wholesaler to 13 cents per ounce of the net weight listed by the manufacturer. This would change the basis of taxation from an *ad valorem* method of taxation to a weight-based method. An *ad valorem* tax is based on the value of the good being taxed. The amount of revenue collected depends on changes in the quantity sold and the value of the good. A per unit tax is dependent only on the quantity of the good being sold. Over time, however, a weight-based method of taxation would not yield the benefits from inflation and product price increases. Revenue growth would be solely dependent upon increasing demand for the product. Currently, ten states utilize the weight-based method of taxation. Because of the health concerns resulting from using this product and the conversion of the basis of the tax from a percentage-basis to a fixed-rate basis, tax revenue from this source is expected to decline over time.

According to the Department of Revenue, tobacco products other than cigarettes amounted to \$5,318,134 in FY2006-07. Moist snuff tobacco accounts for an estimated eighty percent, or \$4,254,507, with cigars, chewing tobacco, dry snuff, and other types of tobacco products accounting for the remaining twenty percent in this category. Since FY1999-00, moist snuff tobacco sales have increased at an average annual rate of growth of 5.5% per year. Based upon the latest available data from the Federal Trade Commission and tobacco industry statistics, over 1,000,000,000 units were sold in the United States in 2005. These products are usually sold in small, circular tin cans containing an average of 1.2 ounces of tobacco. South Carolina accounts for an estimated three percent of the moist smokeless tobacco market. Applying a three percent market share and adjusting the unit sales for growth yields an estimated 35,680,000 units (cans) sold in South Carolina in FY2008-09. Using an average price of \$2.66 paid by the wholesaler to the manufacturer and applying a tax rate of five percent on the manufacturer's value yields an estimated \$4,745,534 in General Fund business license tax revenue in FY2008-09 under the current method of taxation. Under the weight-based system of taxation, the same 35,680,000 units of moist snuff tobacco containing an average of 1.19 ounces of finely cut tobacco multiplied by 13 cents per ounce yields an estimated \$5,519,806 in General Fund business license tax revenue in FY2008-09. By adopting a weight-based method of taxation on moist snuff tobacco products, this bill would increase General Fund business license tax revenue by an estimated \$775,000 in FY2008-09.

Section 8. This act takes effect upon approval by the Governor.

Explanation of Amendment (May 15, 2007) – By the Senate Finance Committee

Section 1. This section would add Section 12-21-625 to impose 45-cent surtax on each pack of 20 cigarettes beginning July 1, 2007 and is expected to generate an estimated \$152,800,000 in FY2007-08. The surtax would be credited to the General Fund and used for those purposes as the General Assembly determines by law.

Section 2. This section would add language from S.B.656 that would reduce the sales and use tax on the sale of unprepared food which is purchased with United States Department of Agriculture food coupons from three percent to one percent beginning November 1, 2007. This section would reduce sales and use tax revenue by an estimated \$90,000,000 in FY2007-08. This section would reduce

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General Fund sales and use tax revenue by an estimated \$72,000,000 and would reduce EIA revenue by an estimated \$18,000,000 in FY2007-08. This amendment does not contain an EIA hold harmless provision.

Beginning with the February 15, 2008 forecast by the BEA, if the growth rate in General Fund revenue for the upcoming fiscal year is at least five percent compared to the current fiscal year's estimate, then the sales and use tax rate on food purchased at grocery stores may be reduced by one-half of one percentage point beginning the following July 1. The BEA would notify the Department of Revenue in writing that this requirement has been met. That rate would remain in effect until another formal review of General Fund growth rates is undertaken by the following February 15th forecast. This process would continue in one-half of one percentage point increments until the sales and use tax on food purchased at grocery stores is wholly eliminated.

Section 3. This section states that effective on the July 1st that the sales tax on food is from Section 2 is reduced to zero percent; the sales tax on food exemption would only apply to the general state sales tax. Counties and municipalities may still apply sales tax on eligible food items in those local areas that have passed local option sales taxes.

Section 4. This section would amend Section 12-6-510(A) to reduce the lowest marginal tax rate from 2.5% to 0% and additionally increasing the starting income level of the 3.0% marginal rate bracket. We estimate that reducing the 2.5% tax bracket to 0% would reduce total South Carolina individual income tax \$86,361,150 in FY2007-08.

Section 5. This section would create in the State Treasury the Health Care Trust Fund that is separate and distinct from the General Fund that would receive state appropriations of \$90,000,000 each fiscal year. This section would also create in the State Treasury the Smoking Cessation Trust Fund that is separate and distinct from the General Fund that would receive state appropriations of \$5,000,000 each fiscal year. Earnings on these funds must be credited to each respective fund and any remaining balance in the fund at the end of each fiscal year may be carried forward to succeeding fiscal years.

Section 6. This section would add language from S.B.704 that would amend Section 12-21-735 to require a manufacturer or wholesaler of cigarettes to affix a tax stamp to the bottom of each individual package of cigarettes that is intended for sale or distribution within the State. The Department of Revenue would prepare and distribute rolls or sheets of the tax stamps directly to manufacturers and wholesalers of cigarettes. Each roll or sheet of tax stamps would have a separate and unique serial number to be recorded by the Department of Revenue of each licensed manufacturer or wholesaler that purchased the tax stamps. A similar procedure and series of tax stamps would also be issued for those packages of cigarettes that are exempt from the cigarette tax. Cigarette manufacturers and wholesalers may be authorized by the Department of Revenue to make a meter impression on a package of cigarettes instead of using a tax stamp. Each manufacturer or wholesaler would be assigned a unique meter impression number that may not be used by any other manufacturer or wholesaler. Stamps must be affixed by licensed manufacturers or wholesalers in a denomination that equals at least the tax due on cigarettes in the package. A jobber or retailer may only obtain cigarettes from a licensed wholesaler and may only sell cigarettes if a tax stamp is visible and located on the bottom of each package. Since the bill makes no explicit reference to a price charged by the Department of Revenue per individual tax stamp, roll, or sheet of tax stamps, this bill is not expected to have an impact on General Fund revenue in FY2007-08.

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Section 7. This section would amend Section 12-21-620(2),(3) to change to basis of taxation on snuff from five percent of the manufacturer's price at which a manufacturer sells to a wholesaler to 13 cents per ounce of the net weight listed by the manufacturer. Snuff is defined in the amendment as "any finely cut, ground or powdered tobacco that is not intended to be smoked", but not "to be placed in the nasal cavity". This would limit the range of tobacco products to moist snuff tobacco. These products are usually sold in small, circular tin cans containing an average of 1.2 ounces of tobacco. Based upon the latest available data from the Federal Trade Commission, there were over 958,000,000 units sold in the United States in 2005. An estimated one percent of total units sold, or 9,580,000, is sold in South Carolina. Using a price of \$2.11 paid by the wholesaler to the manufacturer and applying a tax rate of 13 cents per ounce does not reduce General Fund business license tax revenue below the current level of tax collections. This section is not expected to have a measurable impact on General Fund revenue in FY2007-08. Because demand for snuff is declining over time due to the health concerns resulting from using this product and the conversion of the basis of the tax from a percentage-basis to a fixed-rate basis, tax revenue from this source is expected to decline over time.

Section 8. This act takes effect upon approval by the Governor.

Explanation of Amendment (April 25, 2007) – By the House of Representatives

This amendment would impose a 30-cent surcharge on each pack of 20 cigarettes beginning January 1, 2008 and is expected to generate an estimated \$53,635,000 in FY2007-08. Section 2 of the amendment would amend Section 12-36-910(D) to reduce the sales and use tax on food purchased for home consumption by U.S. Department of Agriculture food coupons from the current rate of three percent to one and four-tenths of one percent beginning January 1, 2008. This would reduce the sales and use tax on grocery store items by an estimated \$54,000,000 in FY2007-08. Of this amount, General Fund sales and use tax revenue would be reduced by \$43,200,000 and EIA funds would be reduced by \$10,800,000 in FY2007-08. This amendment contains an EIA hold harmless provision and requires the transfer of an estimated \$10,800,000 from the General Fund to the EIA Fund in FY2007-08 as a result of the one and sixth-tenths percent reduction in the sales tax rate of eligible food items. The amendment also requires that in any fiscal year that the business license tax on cigarettes is greater than 7-cents a pack, the General Assembly shall appropriate \$1,000,000 to the Department of Agriculture for research and promotion of healthy lifestyles with food grown in South Carolina. This act takes effect January 1, 2008.

Explanation of Amendment (March 20, 2007) – By the Licenses, Fees, Insurance Tax Subcommittee

This amendment would add Section 12-21-625 to increase the levy on each cigarette made of tobacco or any substitute for tobacco by one and one-half cent on each cigarette. This equates to a 30-cent surcharge on each pack of 20 cigarettes, raising the state excise tax to 37 cents per pack of 20 cigarettes. The higher surcharge is expected to generate an estimated \$107,270,000 of business license tax revenue in FY2007-08. Since the effective date of this act is January 1, 2008, the higher surcharge is expected to generate an estimated \$53,635,000. The Department of Health and Environmental Control must be allocated five percent, or an estimated \$2,681,750 of cigarette tax revenue, to fund a Youth Smoking Prevention and Cessation Fund. DHEC is also allocated an amount equal to one cent of the cigarette tax increase, or an estimated \$1,787,500, that must be used in the Superb Fund for the cleanup of underground gasoline tanks to satisfy any existing Environmental Protection Agency deficiencies. Upon satisfaction of the deficiency, the one cent must be returned to the Reserve Trust Fund in the DHHS. The Department of Agriculture is allocated \$1,000,000 for research and promotion of healthy lifestyles with food grown in South Carolina. The remaining \$48,165,750 is allocated to a new Health Care Trust Fund to be used by the Department of Health and Human Services (DHHS) to expand coverage under the state Medicaid program to children eighteen years of age and under whose family income does not exceed one hundred percent of the federal poverty level. Any remaining funds must be used by the

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DHHS to provide Medicaid coverage to individuals nineteen years of age and older who are uninsured and whose family income does not exceed one hundred percent of the federal poverty level. There is created within the DHHS a new Reserve Trust Fund for the state Medicaid program to fund any shortfalls in the DHHS operating budget up to one and one-half percent of DHHS's operating budget from any unobligated proceeds from the surcharge on cigarettes. Because the higher tax will reduce cigarette demand, the Business License tax currently allocated to the General Fund will be reduced by an estimated \$1,090,750 in FY2007-08.

Section 2 of the amendment would amend Section 12-36-910(D) to reduce the sales and use tax on food purchased for home consumption by U.S. Department of Agriculture food coupons from the current rate of three percent to one and one-half of one percent. This would reduce the sales and use tax on grocery store items by an estimated \$101,250,000 in FY2007-08. Since the effective date of this provision is January 1, 2008, sales and use tax revenue would be reduced by one-half, or an estimated \$50,625,000 in FY2007-08. The amendment contains an EIA hold harmless provision and requires the transfer of an estimated \$23,636,813 from the General Fund to the EIA Fund in FY2007-08 as a result of the three and one-half percent reduction in the sales tax rate of eligible food items.

Section 5 of the amendment would authorize that cigarette tax stamps be affixed to each package of cigarettes before they may be sold at retail establishments. The stamps must be purchased at the Department of Revenue and the amendment allows for a five percent discount on stamp purchases of \$25 or more. Based on an estimated 357,567,000 packs of cigarettes and applying the one-cent stamp tax and the five percent discount for one-half of the fiscal year, this section would increase General Fund business license tax revenue by an estimated \$1,700,000 in FY2007-08.

Section 6 of the amendment would allow the act to take effect January 1, 2008.

Explanation of Bill filed February 21, 2007

This bill would amend Section 12-21-620 to increase the levy on each cigarette made of tobacco or any substitute for tobacco to two cents on each cigarette. This equates to a 33-cent surcharge on each pack of 20 cigarettes, raising the state excise tax to 40 cents per pack of 20 cigarettes. The higher surcharge is expected to generate an estimated \$116,948,000 of business license tax revenue in FY2007-08. Of this amount, an estimated \$22,956,606 is allocated to the Department of Health and Human Services (DHHS) to expand coverage under the state Medicaid program to children eighteen years of age and under whose family income does not exceed two hundred percent of the federal poverty level. The remaining funds must be allocated to a new Health Care Trust Fund to be used by the DHHS to provide Medicaid coverage to individuals nineteen years of age and older who are uninsured and whose family income does not exceed one hundred percent of the federal poverty level. Because the higher tax will reduce cigarette demand, the Business License tax currently allocated to the General Fund will be reduced by an estimated \$2,403,252 in FY2007-08. This bill also reduces the sales and use tax rate on the sales of unprepared food purchased in grocery stores to two percent from July 1, 2007 through June 30, 2008, and to one percent from July 1, 2008 through June 30, 2009, and is eliminated effective July 1, 2009. The reduced rates of sales taxation on eligible food items purchased in grocery stores will reduce sales and use tax revenue by an estimated \$73,828,000 in FY2007-08, \$80,754,000 in FY2008-09, and \$88,181,000 by FY2009-10. This bill also contains an Education Improvement Act (EIA) hold harmless provision. The amount of revenue that the EIA would have received is to be estimated by the BEA and transferred from the General Fund to the EIA Fund. We estimated the EIA hold harmless amounts to be \$14,800,000 in FY2007-08, \$16,200,000 in FY2008-09, and \$17,600,000 in FY2009-10.

/s/ WILLIAM C. GILLESPIE, PH.D.

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Chief Economist

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^{1/} This statement meets the requirement of Section 2-7-71 for a state revenue impact by the BEA, or Section 2-7-76 for a local revenue impact or Section 6-1-85(B) for an estimate of the shift in local property tax incidence by the Office of Economic Research.